RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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July 27, 1988 **LETTER 996**

July 15 DJIA 2129.45; PTI 2761; A-D Ratio -9.11
July 22 DJIA 2060.99; PTI 2745; A-D Ratio -10.11
Current Dow Yield: 3.62%; Dow P/E: 14.3
Dow 200-day mov aver: 2015; DowPow: 835

SQUEEZE: On July 15 the yield differential in favor of high-grade bonds over stocks jumped to 6.05%, a high for the year. The yield on the Dow was a low 3.51% against a fat yield of 9.56% for AAA-rated bonds.

THE PICTURE: The stock averages have been acting erratically, but to my mind the important consideration is that the averages have been growing immune to good news. Consider this: The nation's business (following the crash) has been better than almost anybody expected. Factory usage is literally at capacity. Exports are surging. Unemployment is at record low levels. Car sales are holding up. The dollar has bottomed turning strong. In the face of all this good news the Dow is sluggish and still 600 points under its 1987 bull market high!

How to account for this? I account for it this way -- a bear market is in force. The good news has been discounted, and the market is no longer interested in today's good news. The market is looking beyond the good news, beyond the election. The market is looking for trouble to start later this year (after the election) or possibly in 1989.

On July 15 my Primary Trend Index rose to a new all-time high of 2761. I don't consider the absolute level of the PTI to be significant, but I do consider the trend of the PTI to be significant. Why the all-time high? The new PTI high is a product of last year's rapid crash action and then the slow, gradual recovery.

From its August '87 peak the PTI headed down, hitting a low on December 4. Thus, the PTI declined for a period of a bit over three months (see page 2 chart). From its December 4 low, the PTI turned up. It has been climbing ever since, a period of seven months. Thus the advancing period for the PTI is nearing twice the declining period.

In January the PTI advanced above its 89-day moving average, signaling that the secondary trend of the market was up. The PTI has been in this mode ever since, and, of course, for those subscribers who trade strictly on the trend of the PTI, this was all they needed to know. The PTI hit a high of 2761 on July 15, unconfirmed by the Dow. As veteran subscribers know, we won't have real trouble in the stock market until the PTI goes into a definite downtrend.

The action of the advance-decline ratio is another and much less pleasant story. As described in the last Letter, we now have a serious divergence between the Dow and the rest of the market as measured by the A-D ratio. The A-D ratio recorded its high on March 17, declined, then rallied to a lower peak on April 12, declined, then rallied to a still lower peak on July 5. Against this series of lower tops, the Dow advanced to successive new highs (see page 2 chart).

The price/breadth parting of the ways is what I term a "triple divergence." In the past, this type of serious divergent action has triggered major declines. It remains to be seen whether the current breadth/price divergence will signal an end to the 1988 rise and a resumption of the primary bear market.

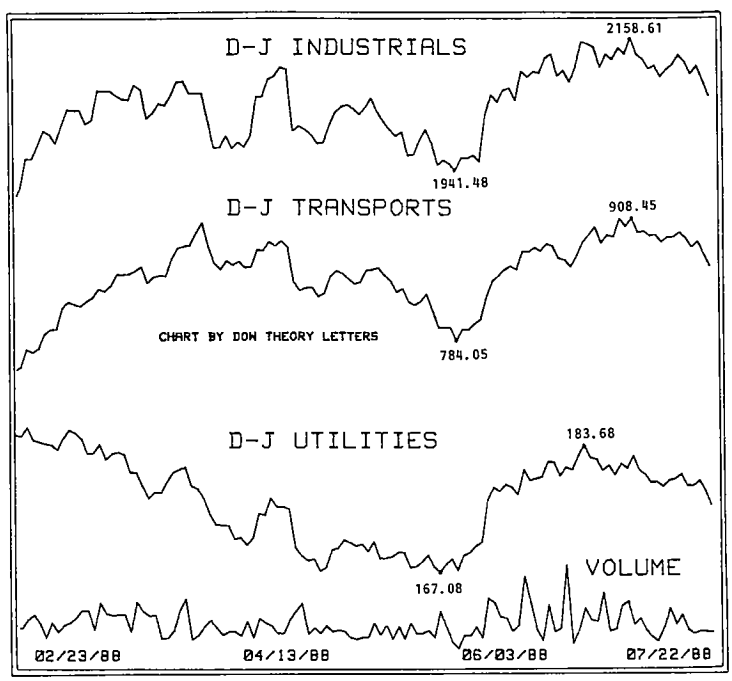
Now here's an eerie comparison. In 1987 the D-J Utility Average topped out in January and the A-D ratio topped out in March. The PTI in 1987 continued up until August, then turned down just ahead of the D-J Averages. This year again the D-J Utility Average topped out in January and the A-D ratio topped out in March. The PTI is still in a bullish mode , but whether July 15 was the peak for the PTI remains to be seen.

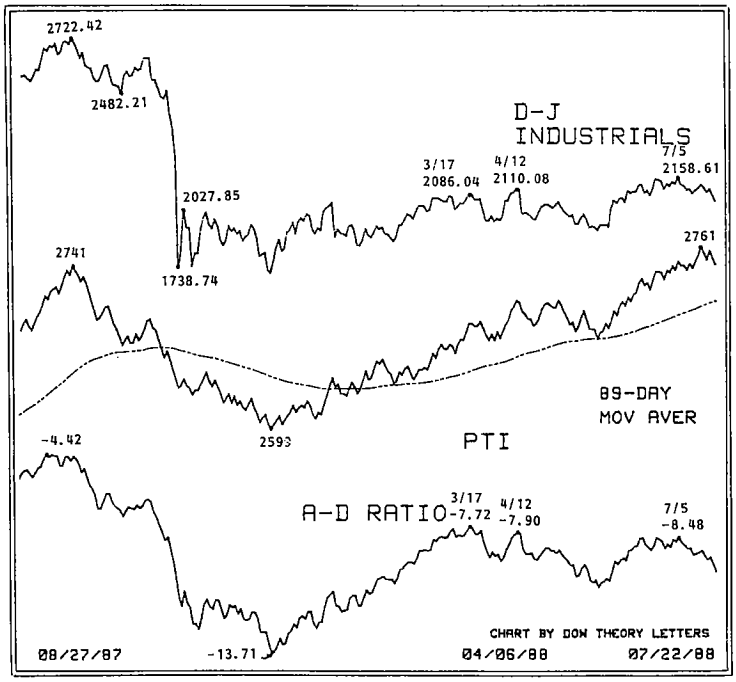
Here's another most interesting situation. According to the decennial pattern the years **ending in either 5 or 8** (such as the current 1988), have tended to be the strongest years in the decade (as you can see on this Ned Davis chart, see bottom left, page 2). The typical pattern for an "8" year is for the Dow to record a low in the first quarter and then to be strong throughout the rest of the year.

In May of this year the Dow recorded a low of 1941.48. It will be most important to see whether the Dow can perform well during the second half of '88. Often, what the market does not do is as important as what the market does do. Therefore, if the market is sluggish or weak during the second half of '88, this will represent definite counter-cyclical action, and I would take such action to be bearish (particularly if Dow 1941.48 is violated)

THE PICTURE: Why is it so few people can accept the thesis that this is a bear market? I've been giving a lot of thought to this question, and here are some of my conclusions:

(1) People think to themselves, "The crash occurred last October, but since then nothing bad has happened. So c'mon, if this is really a bear market, why isn't Wall Street falling apart?"





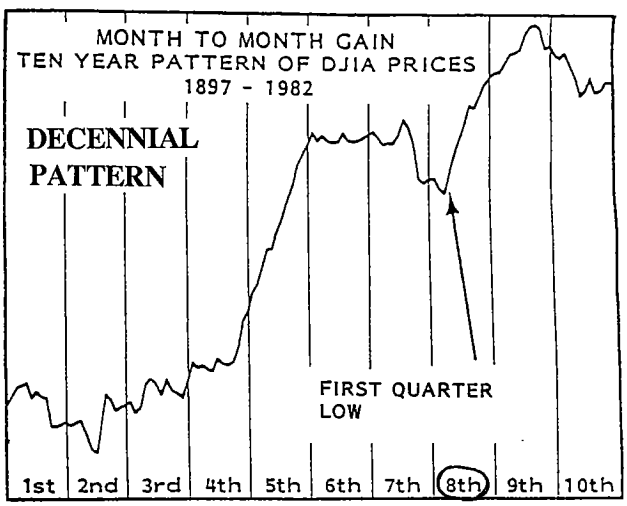
This is a reasonable question, but the same question could have been asked during any of the extended primary bear market rallies of the past. History provides many examples of extended bear rallies which served to calm the nerves and raise the hopes of investors. A study of the Averages also shows us that bear markets (and, of course, bull markets as well) spend a good deal of time going sideways or going against the prevailing trend.

(2) People know that the market crashed last October, but they reason, "So what! That was an isolated, freak event that happened nine months ago. Why should what occurred last October 19 affect conditions today?"

Good question. It isn't so much that the crash is affecting conditions today, it's simply that the crash confirmed (in the most dramatic way possible) that the primary trend of the market had turned bearish.

If you remember, the Dow Theory signaled a bear market on October 15. On October 19 the stock market crashed, providing the the most powerful confirmation of a major trend reversal in NYSE history. That's how I view the October phenomenon. In other words, it wasn't that the crash necessarily affects conditions today, it's what the crash implied that is so vitally important.

(3) People can't accept the idea that once a primary bear signal is rendered, the result is inevitably a bear market. It's that word, "inevitably," that people can't swallow.



Men like to think that they are masters of their fate. The very idea of anything being "inevitable" in the stock market or the economy is one that they find difficult, if not impossible, to accept. Thus, I continually get the question, "Russell, what would you have see in order for you turn bullish again?" And I answer, "I'd have to see the bear market go through its three phases, and then I'd have to see all the indications of a bear market termination." There's no single event -- no Presidential edict or quick fix or Congressional manipulation that will end this bear market. The bear market will end in only one way -- **downside exhaustion.** Bear markets end when the last seller has bailed out, they don't end with an exciting and unexpected news event or a fine batch of corporate profit statements or rosy predictions from economists.

I want to write a bit more about the inevitability thesis, since this is the point that most people refuse to accept. If I tell you that night will inevitably follow day, you will believe me since you experience this every 24 hours. If I tell you that you will eventually die you will accept this, since you know from experience that your grandparents have died or your great-grandparents have died or someone you know has died. You see people getting older, and the logic of eventual, inevitable death is accepted.

But when I say that a bear market has started, and that it will (in due time) take stocks from extreme overvaluation, such as that which existed last summer, to extreme undervaluation, such as that which existed in 1974 or 1949 or 1942, the average person cannot conceive of this. They can't or won't accept it.

Why the disbelief? One reason is this feeling that the government, Congress, the President, somebody, will be able to press the right buttons and thereby "make everything all right again." "They won't let it happen," I am told, or "the US can't afford another recession or a depression."

And I tell people, "Look at past history. Study past periods when stocks were overvalued, when a bull market was in its third speculative phase, when a primary bear market was signaled. Study those periods and see how it all ended."

And, of course, very few people will do the work. They'd rather believe that history is a series of unconnected coincidences or that "this time it's different." So be it. "Those who ignore history are doomed to relive it."

Each bear market is unique, and each bear market has its own way of separating the players from their bank accounts. Some bear markets (such as 1937) start with broadly separated double tops, some start with a crash (1929), some start with a long extended period of distribution (1907), and today's bear market started with an historic crash, then a long, mildly-sloping upward correction which is raising the hopes of millions of investors.

The current bear market is dealing with many unique circumstances such as unprecedented debt levels, negative US trade balances, global and interconnected stock markets, program trading, massive bond and credit markets, high levels of interest rates, and a reserve currency (the dollar) which has lost half its value in terms of the currencies of other developed nations.

Thus, we can expect surprises, unorthodox market action, and unprecedented news events in the period ahead. But it's still a bear market. That's the operative fact -- even though an army of doubters continue to insist that "this time it's different."

On top of all this, we have to deal with the average person's inability to envision change. People tend to believe that things will always be the same, that good times beget more good times and bad times give way to more bad times. It's human nature, but, of course, this kind of non-thinking tends to be an investor's worst enemy.

Here's a concept I want to introduce in this discussion. If you believe in the inevitability of bull and bear markets, if you believe that stocks go from extreme overvaluation (i.e., a bull market top) to extreme undervaluation (i.e., a bear market bottom), then what

about events which temporarily move the market counter to the prevailing primary trend?

History shows that such events simply serve to extend the primary trend. For instance, the Eisenhower heart attack of Sept. 24, 1955, occurred in the midst of a long primary bull market advance. The stock market panicked on the news, dropping 10% in a period of two weeks. But in retrospect we know that from a market standpoint all the Eisenhower panic did was erase an overbought condition and extend the bull market. After the panic, the market advanced steadily to April 1956, whereas the market probably would have topped much earlier if it had not been for the panic action set off by the President's heart attack. The point is that the Eisenhower heart attack didn't end the bull market, it merely extended it.

I view today's business news in exactly the same way. Today's good business news will only serve to lengthen this bear market. The bear market will be extended and it will be deepened since the continued stream of optimistic news is bringing new investors into the market and causing other investors to hold their stocks when they should be selliing. Just as bad news extends the life of a bull market, good news extends the life of a bear market. **Ultimately, in the end, the primary trend of the market always prevails.**

Some months ago my friend, Charles Allmon (*Growth Stock Outlook,* PO Box 15831, Chevy Chase, Md. 20815) included this very pertinent list of bear markets since the 1920s along with the statistics on what happened. I strongly recommend that you study this listing. For many new subscribers, it should prove an eye-opener.

Bear Market Date	Duration (months)	Price To Book (%) Beginning	Price To Book (%) End	Dividend Yield (%) Beginning	Dividend Yield (%) End	% Decline
1919-21	22	248%	138%	4.8%	6.1%	46.6%
1929-32	34	418	50	3.3	11.2	89.2
1937-38	13	220	114	4.5	5.0	49.1
1939-42	32	163	87	3.9	6.9	40.4
1961-62	6	190	134	3.1	4.3	27.1
1966	8	209	156	3.2	4.3	25.2
1968-70	18	189	110	3.2	5.0	35.9
1973-74	23	152	77	3.4	6.5	45.1
1976-78	17	127	83	4.1	6.5	26.9
1987 ?	?	258	?	2.6	?	?
Average	**19.2**	**213%**	**105%**	**3.7%**	**6.2%**	**42.8%**

INVESTMENT POSITION: I often wonder what flaws of character produce losses for investors. Here's the way I see it. Ignorance is probably No. 1. People don't study the market, don't study history, don't read the great works of Dow, Hamilton, Rhea, Schaefer. They want to make money without working. So I guess you can lump laziness with ignorance. They're two sides of the same coin.

I'd put impatience as No. 2. People won't wait for bear market bottoms to buy. Lump greed together with impatience. Greed keeps people from selling out at the tops. Fear is No. 3. People are afraid to buy at the great buy spots. The only way to counter fear is through knowledge, and that goes back to No. 1 above. If you want knowledge, you've got to work, work, work.

Oh yes, ursa, the bear, is king of the box. And no, I haven't "changed my mind," it's still a primary bear market, and it's a bear market in its first phase.

CLOSER, CLOSER: Back in New York City around 1959-60 I used to meet with one of my early subscribers. He was from Switzerland. His name was Jay Pfister. Jay was a total gentleman of the old school. He always wore a white shirt, a navy blue suit, and a red foulard necktie. Jay always walked with a black malacca cane, and his manners were impeccable. He had owned a large chemical company, but back in 1936 Jay sold his company to the DuPont Corp. Jay then retired, living very well on what he termed his "DuPont money."

About three times a year I would meet Jay for lunch -- always at the Plaza. And on each occasion Jay, who owned a second home in La Jolla, would say, "Richard, I don't know why you live here in the City. Some day you'll have to come out and see La Jolla. I've traveled all over the world and I can tell you, there's no place like La Jolla."

I guess it was 1960 when I decided to take Jay's advice; I flew to California and looked over the whole San Diego area and, of course, La Jolla. I was smitten. Everything Jay had told me about La Jolla was true. All that cold New York winter I was tortured by visions of San Diego. In the Spring I made up my mind. We packed up and headed West.

Jay was a gold bug, one of the very early ones. Over and over he would describe how gold some day "would go up, up, probably to over two or three hundred dollars an ounce." Jay Pfister died around 1970. Sadly, he never lived to see the great gold boom which culminated with a price of over 800 dollars in 1980.

There's a story Jay told me as we sat over lunch at the Plaza, a story I've never forgotten. Jay said, "One day I was sitting in my New York apartment overlooking the East River, and I noticed two large ships heading towards each other. I thought to myself, 'There's something very strange here, because if these ships continue on the path they're on -- well it's ridiculous, because they will surely crash.' And yet they did continue moving toward each other. And do you know what -- to my amazement they crashed. The whole episode was absolutely unbelievable."

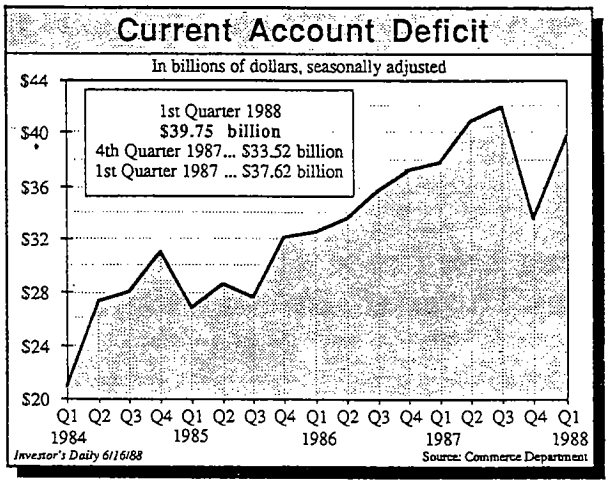
I don't know why that story stuck in my mind all these years, but I guess it does illustrate something else that I see today. It's the US deficits. The federal deficits keep rolling along, and Americans have actually grown used to them. All sorts of warnings are issued year after year, but nobody has the guts (certainly not Congress or the president) to do anything about the deficits. If the deficits continue, I say to myself, then the US economy will surely cave in, but that seems hardly possible. Then I think back to Jay Pfister's story, and I know that it can happen.

Aside from the shameful federal deficits, we have the trade deficits, which everyone now believes are looking "better," since they have been shrinking a bit over the past few months.

But the much bigger picture for the US is the current accounts deficit, which is the broadest measure of this nation's international position. The current account measures ALL the nation's international transactions, which include the sale of goods and services and the return on overseas investments.

A few weeks ago the Commerce Dept. reported that the US registered its first service deficit ever -- a $700 million deficit. In addition, the report showed that the US is now paying more interest on its foreign debt than it earns from its interest on loans in foreign nations. As US debts pile up overseas, as profits from US corporations (that have been taken over by foreign interests) are shipped overseas, the US current account deficit grows. As one economist put it, "We used to import real goods (cars, VCRs, chips, etc.) and pay for them with US paper. Now we are giving foreigners US paper (interest payments on our loans) and getting back nothing for our paper."

This chart shows the picture of the US current account (chart courtesy of *Investor's Daily*). If there's any dramatic improvement, I don't see it on the chart. The US current account deficit grew 18.6% in the first quarter to $39.75 billion, up from $33.52 billion in the fourth quarter of 1987. The 1988 first quarter deficit was up 5.7% over first quarter 1987. So that's the real picture. And the costs to the US are compounding as the debts mount each month and as we pay more and more to our foreign creditors (and, of course, as foreigners continue to buy up US property and businesses with the money they are accumulating).



DOWPOW: The action of my proprietary indicator, DowPow, continues to fascinate me. For new subscribers I should state that DowPow is the Dow adjusted (daily) for the action of the advance-decline ratio. For example, if the Dow rises 20 points on a given day and the breadth is barely positive, DowPow will hardly budge upward. But if the Dow rises 20 points in a day and there are 1300 advances and 270 declines, DowPow will show a substantial rise.

At the October 19 crash low DowPow was 848, having dropped from a bull market high of 4150. Two days after the crash, on October 21, DowPow surged to 1596. DowPow then fell irregularly to a post-crash low of 519, recorded on December 4.

Now the extraordinary part of the story is that since December 4 DowPow has been sluggish, very sluggish. On January 7 DowPow rose to 1153, which was well below the October 21 peak. On March 8 DowPow rallied to a high of 1166, still well below the October 21 peak. On April 21 DowPow hit a peak of 1083.

DowPow then declined to a May 23 low of 529, just 10 points above its bear market low of 519. Most recently, DowPow rallied to a July 5 high of 1004, but still well below all previous peaks. From there DowPow turned down again.

What's going on? Is DowPow incapable of rising? Is there "a screw loose" in the DowPow equation? Or is DowPow telling us something important that we should know?

Back in Letter 988 I included a chart which was run off by computer-expert John Carder (John is the only other person who knows the DowPow formula). I include that chart again, and here we note that DowPow is indeed very capable of rising. In fact, as you can see on the chart, during the sensational bull market rise of 1982-87 DowPow rallied thousands of points. That, I believe, answers the question of whether DowPow can rise.

So, I ask myself, what is the meaning of DowPow's pathetic performance since the October 19 crash low? As I interpret it, DowPow's resistance to advance is telling us that the bear market rally since last October has been ominously weak (see small weekly chart, bottom right). Furthermore, I think the implication is that if nine months of effort on the upside can't produce any real progress in DowPow, then we're going to see "a killer" on the downside when this bear market rally finally burns itself out. Personally, I'll be fascinated to see if this simple but fundamental logic works out in the period ahead.

NOTES & QUOTES: The boys are playing it ultra-safe, and 1988 is turning out to be the year of the "no-platform, no-promises, no-specifics election." It's the year of "Just gimme a win." Duke's main problem -- he's too short (seriously, the taller candidate usually wins).

Nevertheless, my feeling is that Dukakis looks more and more like our next President. Personally, I believe the public may have had enough of the debt-filled Reagan "glory years." Americans now see the massive Reagan bills coming due. They also see the results of the Reagan "military build-up" -- the flawed B-1 bomber, the half-billion-dollar-a-copy Stealth Bomber which may not be all that stealthy, and SDI which may turn out to be an expensive, unworkable fantasy. They also see more people employed in DC than ever and a budget (as usual) which is out-of-control.

The Duke's low-profile, dull, no-nonsense appearance is in stark contrast to Reagan's rosy, "morning in America" look. With the picking of Bentsen for VP, fears of a too-liberal Democrat Administration have been eased.

But in a scathing editorial (July 13) the *WSJ* notes that the Dukakis/Massachusetts budget is a fiasco. The state has a $450 million budget shortfall, and "to preserve a facade of a balanced budget, the Governor has proposed to drain every find in sight. The legislature, with a 4-1 Democratic majority, has been balking."

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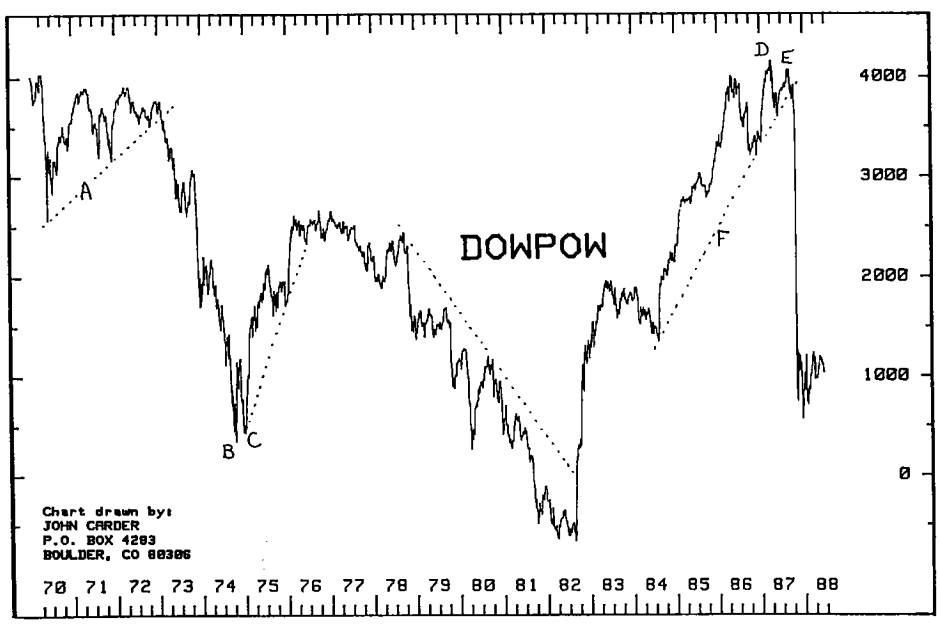
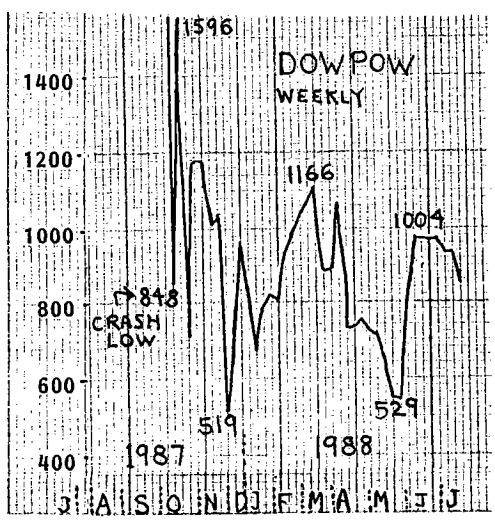
Here are some interesting facts, courtesy of *Marketrend* (Butcher & Singer) and Yale Hirsch's fascinating 1988 *Stock Trader's Almanac*:





"Lame duck" presidents' final years have been losers for stock prices. Reagan now in the final year of his second term is a "lame duck" president. Over the past 164 years other lame ducks were Eisenhower (1960), Roosevelt (1940), Wilson (1920), Cleveland (1896), Grant (1876), and Jackson (1836) . The stock market was down in each of these presidents' final year. A down market in '88 would just about cook Bush's goose.

Over the past 40 years no party has held the White House for over two terms. A change in parties is usually preceded by a decline in stock prices during an election year.

Over the past 150 years, no VP has gone from VP to President via the election process. VP Nixon became President, but that was 8 years after his 1960 losing attempt. If Bush makes it, he'll be the first VP in 150 years to go directly from VP to President via the elections.

* *

Is there money in cable TV? Better believe it. According to *Barrons,* John Malone's giant Tele-Communications Inc. (nation's largest cable TV system) will have a cash flow of $1 billion this year. That's more than the <u>combined</u> cash flows of CBS, ABC, and NBC.

* *

Japanese real estate prices are up in the wild blue yonder. The value of Tokyo plus Kanagawa Province is comparable to the worth of the entire US -- how's that for the ultimate financial insanity? But since last September, prices in Tokyo (where the boom has been centered) have eased. Office prices in some parts of Tokyo have dropped substantially. On July 17 the Nikkei stock average dropped 250 points; the next day it dropped over 500 points, the biggest slide of the year. The Japanese stock market will be well worth watching in the weeks ahead. A Nikkei under 27,000 would be bearish.

* *

Bob Prechter in his last Letter lauded the newspaper, *USA Today.* I agree 100%. I was an early admirer of the paper. I thought it was great from the beginning, and I still love it (it's one of the nine newspapers I read each day). Its circulation is now pushing an incredible 1.75 million a day, but it's got a problem. It can't make a profit. The *New York Times* (July 11) estimates that *USA Today* has cost Gannett $500 million since its inception in 1982. Main problems -- high cost of newsprint and lack of ads. Even at the current fat price of 50¢ a copy, *USA* can't make a living. And the *Times* says it has "virtually no chance of making a profit soon." Pray for it -- it's a fine (even a great) newspaper.

Here's another plug for another great newspaper, the *Christian Science Monitor.* If you've never read it, I strongly advise you to try it. Each daily issue is filled with well-written, informative, original-research articles. I wouldn't be without the *Monitor.*

Magazines I wouldn't be without -- *New York* magazine, the *Economist, Vanity Fair* (along with *Elle,* these two are the success stories of the last few years), the *Washington Post Weekly, New York Times Sunday Magazine* , and *Manhattan, Inc.* These are just a few of the dozens of mags I read each week. And, oh yeah, blushingly I admit that I like the *National Enquirer.* OK, so it is low-brow. But c'mon, you gotta have fun too (besides, Tony Pope, the owner, was a schoolmate of mine).

* *

In a recent Notes & Quotes I included a little piece on the great new Canadian tax changes. Wow, did I hear it from Canadian subscribers! So forget it, the piece was dead wrong. Dozens of Canadian subscribers set me straight. Typical letter, "As concerns Canada and its economic policies, your info source is about two years old. Our government did institute the $500,000 tax-free capital gain, but it fell by the wayside in Feb. '87 and is now $100,000 minus investment income. As concerned capitalism being 'the way to go,' this country has more expensive socialism than any country outside of Israel or Scandanavia, and carries twice the per capita national debt of the US. Also, I'll bet the post office is far worse than anything Ross Perot has to deal with." Anyway, judging from letters received here, investors are anything but happy about the way Canada is going.

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Gold-plated athletes. Here what the top sports guys are making in endorsements for products (this is on top of salaries, of course). Arnold Palmer is No. 1 with $8 million, Jack Nicklaus No. 2 with $6 million, Boris Becker No. 3 with $6 million, Greg Norman No. 4 with $4.5 million, Michael Jordan No. 6 with $4 million, Ivan Lendl is No. 6 with $3 million, John Madden is No. 7 with $3 million, Jim McMahon No. 8 with $3 million, San Diego's Dennis Conner No. 9 with $2 million, Chris Evert No. 10 with $2 million.

* *

Jim Grant (*Grant's Interest Rate Observer,* 233 B'way, NYC 10279) lists eight "late-cycle symptoms" that tend to accompany the tail-end of business expansions. Here they are: (1) interest rates rise, (2) manufacturing capacity tightens, (3) inventory excesses, (4) personal savings rise, (5) home construction falls, (6) stock market declines, (7) new car sales drop, (8) inflation accelerates. Seven out of eight are present today in varying degrees, with the stock market the main holdout.

* *

Iben Browning, a well-known climatologist (he's also a Paine Webber consultant) predicted the current drought based on winter tornadoes along the Gulf Coast (which lead to dehydrated winds in the High Plains). Browning is now predicting "droughts and dust storms . . . repeatedly from 1989 to 1993," and he adds that "every major depresssion has been associated with dust storms." States Browning, "Everything is climate. The climate causes crop failures and famines, and people find this very depressing. They are so depressed that the economy is also depressed."

* *

<u>Statistics</u>: McDonalds' revenues jumped to $5.5 billion last year. They spent $900 million on advertising. Whew! . . . The World Trade Center in NYC averages $100,000 in sales of lottery tickets per week, which makes them the biggest seller of tickets in the state. The Center's commissions run $6,000 per week. . . . Speaking of NYC, Gotham had 3 million overseas visitors last year. Foreign and American visitors spent a whopping total of $12 billion in the City. . . . The Chicago Merc (are you ready for this?) trades $6 billion a day in S&P 500 futures. . . . Remember the parabolic curve in soybeans shown in Letter 994, page 4, and remember my warning? Result: Beans last week dropped 20% in three days, biggest 3-day swoon in memory.

* *

Japan's secret for success -- tax consumption and encourage savings. US's formula for national bankruptcy -- encourage consumption and tax savings. Newest US encouragement to spend, the <u>home equity loan.</u> You can write off the interest on such a loan (up to a principle amount of $100,000), even though you buy peanuts and popcorn with the loan. The plus is the writeoff and the lower interest rate. The catch -- forget what the ad says, the home equity loan is really an enforceable second mortgage on your house. If you can't meet the monthly payments on the loan, you can lose your house.

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"How Are We Doing?" Dept.: For the first time in memory, no US banks are listed in the top 25 internationally. The top 10 are all Japanese. Citibank, the largest in the US, now ranks 28 internationally. Hmmmm.

Jim Blanchard's super 15th Anniversary Conference happens in <u>New Orleans this October 5-9.</u> I spoke at the first one and every one but one since (I missed that one in '86 due to a bypass operation). So you can see that I think a Blanchard seminar is not to be passed up. I'll be speaking at this one too. The 1988 gala features 65 speakers including Kissinger, Rukeyser, Kudlow, Dorfman, Ruff, Prechter, Fosback, Weinstein, Skousen, the Adens, and (the ultimate antidote for a bear market), none other than Mr. Television, Uncle Miltie Berle. New Orleans, by the way, is known for food, not aerobics. To my knowledge, no visitor to Cajun town ever went away any lighter (but you can catch up on your diet when you get home). Call 1-800-322-6267 or 1-504-837-2902. There are earlv-bird discounts.

President Reagan and Congress continue to play a shell game as regards the US budget. The Social Security fund is expected to have a surplus of $38 billion this year. This is part of a reserve which is supposed to accumulate to pay for the retirement of future generations, and this reserve will most definitely be needed. But for deficit reporting purposes, this $38 billion will be included in the

budget. They won't use this $38 billion to reduce the deficit -- but they will incorporate it (call it "creative accounting") in their report to the American people. The whole process is dishonest, shameful, and a disgrace. It should be outlawed.

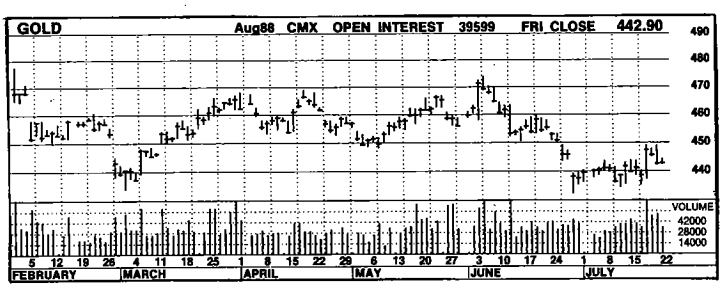
GOLD: From the standpoint of history, there's only one item of value that you don't have to worry about. Stocks can go down the drain, bonds can go bad, houses can lose their value, trends in art can change. But gold is immutable. It is changeless money. That's why men and governments hoard it.

A subscriber wrote to me last week and wanted to know why I "collect" gold coins. "If we have a depression," he wanted to know, "who says that gold will retain its liquidity?"

I wrote back that "2,000 years of history says that gold will retain its liquidity. Jews escaped from Nazi Germany with gold bars, Vietnamese exited carrying gold wafers sewed into their shirt seams, California was opened wide in the frenzy to discover gold, Indian women wear their wealth in gold bangle jewelry, the bible repeatedly mentions gold (note that Christ was betrayed, not with gold, but with baser silver).

Personally, I believe that a policy of accumulating gold coins is an intelligent policy at this stage of the bear market. As long as the Fed can create money "out of thin air," it makes sense to accumulate some of the real thing. Gold is real money, and although the alchemists tried for centuries to turn base metals into gold, none ever succeeded (actually, I guess you have to hand it to the Fed -- they've at least created legal tender out of thin air with the help of accounting tricks).

At this point, people are most apt to turn to gold when they (1) distrust dollars, (2) fear inflation. But with the dollar recently strong, there is little upside pressure on gold. Furthermore, with the bond market now ultra-sensitive to inflation (interest rates explode at any hint of inflation), there is actually not a great deal of market worry about inflation. Thus, gold has been in "no-wheres-ville" for many months, fluctuating between a dollar price of roughly 510 on the upside and 420 on the downside (see chart below, courtesy of *Investor's Daily).* As long as gold holds above 420, I see it as long-term bullish as outlined in recent Letters.



LATE NOTES: I'll be doing more and more of my near-term market analysis here in the late-notes section. Obviously, I write this section last, and writing my near-term comments here means that they will be more timely.

The Dollar Index (a mix of 7 different currencies) gave a short-term point & figure sell signal on July 21 when it sank to 95.70. The lower dollar put pressure on bonds (and interest rates), a pressure which the stock market obviously doesn't care for.

In the last Letter I stated that the most important technical consideration at this time (aside, of course, from the fact that this is a primary bear market) is the continuing breadth/price divergence. The A-D ratio topped out on March 17 at minus 7.72, and it has been forming an ominous series of lower tops -- despite the series of new highs in the Dow. Most recently, the Dow hit a post-crash recovery high of 2158.68 (on July 5), after which the Dow joined the A-D on the downside.

As of this writing, the Dow is only 59 points above the level it closed at on October 21, two days after the crash. That represents precious little progress in nine months, but that's the way bear markets work. They keep you hoping until you suddenly discover that you're losing your shirt. Also, as of this writing the S&P 500 is back to its February level as is the very broad NYSE Composite.

Bear markets (as I've stated dozens of times) are difficult, deceptive, tedious and most definitely out to separate you from your bank account. **The fooler for the bears** is that the bear market has held up as well as it has (after all, it's been nine months since the crash lows, and those October crash lows still remain unbroken). The reason why they remain unbroken is that business has been good, much better than almost anyone expected. The rising tide of corporate profits has served to extend the bear market rally.

The fooler for the bulls is that with all the good corporate news of the past nine months the market has not done a heck of a lot on the upside. Since the crash, for instance, the Dow has recovered only 42.7% of its August to October bear market losses, whereas 50% is the "normal" post-crash expectation. If a 42.7% correction in the Dow is all we're going to see, this bear market is looking more ominous than even I thought it was (as this is written the Dow is still a huge 630 points below its 1987 bull market high!).

The current bear market rally has lasted nine months and now qualifies as one of the longest seconday corrections in market annals. Thus, my feeling is that the bear is itching to "get going" on the downside again, and time is on his side. With each passing week, the forces of the primary bear trend should be growing stronger. Furthermore, the current polls, which favor Mr. Dukakis, can hardly be a comfort to Wall Street.

Question: If this market turns really weak, what are we looking at on the downside? The critical levels to watch on the downside are the April 23 lows on the D-J Averages. Those lows are 1941.48 for the Industrials and 784.05 for the Transports. If those two lows are jointly broken, the bear will be showing his teeth and the picture on Wall Street will turn grim.

I have been besieged by interviewers challenging my view of the stock market, and insisting that the recent upside breakout by the two Averages constituted "a bull signal." I tell them that they don't understand the basic tenets of Dow Theory, one of those tenets being that bull signals can't come in the first phase of a bear market. I tell them that bear markets must undergo three phases and that first-phase breakouts cannot and do not constitute bull signals.

The critics want to know why all three phases of the bear market could not have taken place during the October crash, and I tell them that Dow's Theory has first of all to do with **VALUES,** and that at the October lows stocks were not great values, that yields were still very low, that sentiment was not right, that the public had not sold its stocks, that volume was far too high. In short nothing in October resembled the third-phase termination of a bear market.

So all I can say is that I'll continue to "call 'em as I see 'em." I'll continue to interpret the market under Dow Theory as I learned it from the great Dow Theorists. I'll continue to do my best for my subscribers. That's all I offer -- my best.

The tide of arguments against my market stance is nothing new to me. Frankly, I'm used to it. I heard it in 1958 when I wrote my first bullish *Barrons* article in the face of black pessimism, I heard it in 1966 when I called the end of the great bull market in the face of widespread optimism. I heard it in 1974 when I called for a bull market in the face of black pessimism. I heard it last October when I called a bear market on October 15 (see *Barrons*, Oct. 15) in the face of fantastic optimism.

So I've learned. I don't listen to the critics. And I don't depend on the "experts." I depend on my studies. I depend on Dow's Theory. I depend on my experience. And I depend on whatever intuition the good Lord has given me.

NEXT MAILING: Aug. 10